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No. 93-1213

In The

Supreme Court of the United States

October Term, 1993

MANUFACTURERS HANOVER
LEASING CORPORATION,

Petitioner,

v.

HAROLD G. LOWERY,
Trustee of Robinson Brothers Drilling, Inc.
and Robinson Brothers Drilling Company,

Respondent.

Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Tenth Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF *AMICUS CURIAE* THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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MOTION FOR LEAVE TO FILE AN *AMICUS CURIAE* BRIEF

The American Council of Life Insurance (the "Council") by and through its undersigned attorneys, hereby respectfully moves this Court for leave to file the attached *amicus curiae* brief in support of the Petitioner.

Consent of Parties

1. The attorneys for the Council attempted to obtain consent to file the proposed *amicus curiae* brief (the "Proposed Brief") from counsel for both parties to this action. The attorney for the Respondent refused to give such consent, and accordingly, this motion is necessary.

Interest of the *Amicus*

2. The Council is a nonprofit voluntary trade association, the membership of which totals 634 legal reserve life insurance companies doing business throughout the United States. The member companies of the Council account for 89.9 percent of the legal reserve life insurance in force in this country and afford protection to approximately 140 million insureds.

3. Life insurance companies are among the nation's largest lenders. At the end of 1992, life insurance companies held $881 billion of debt from corporations, partnerships and other business entities.[1] Where loans are

[1] American Council of Life Insurance, 1993 Life Insurance Fact Book Update p.48 (ACLI, Washington, D.C. 1993).

nonrecourse, which is often the case in connection with real estate mortgage loans, or where the borrower's credit rating is less than what would be required to protect the insurer's policyholders, the loan can be closed only with additional financial security such as a guarantee of the indebtedness. Often such guarantees are available only from insiders of the borrower – particularly in the case of small or family-owned businesses.

4. The focal issue of this case – whether the preference provisions of the Bankruptcy Code subject payments to a lender to the insider preference reachback period of one year when the loan is guaranteed by an insider – is of grave concern to the Council and its members. Due to the long involvement of the Council and its members with loans guaranteed by insiders, and in the legislative process leading to the drafting of the Bankruptcy Code and the amendments thereto, the Council is uniquely qualified to comment on the language of the Bankruptcy Code governing preferential transfers and the effect of the so-called *Deprizio* doctrine on the legitimate expectations of lenders.[2]

5. The Council offers this *amicus curiae* brief to support the Petitioner and to explain the serious impact that the holding below, if not reversed, could have on all lenders and their willingness to make loans where an insider guarantee would be required. The Council believes that the arguments presented in the Proposed

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[2] The doctrine at issue in this case was adopted by the Court in *Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186 (7th Cir. 1989), a decision arising in a bankruptcy case, *In re Deprizio*.

Brief are important and have not yet been brought to the Court's attention.

The Proposed *Amicus Curiae* Brief

6. A copy of the Proposed Brief is submitted herewith. The Proposed Brief complies with all of the requirements of the Rules of this Court.

Conclusion

Due to the Council's substantial interest in the outcome of this matter and due to the substantial importance of the issues to be decided, the Council respectfully requests that its motion for a leave to file an *amicus curiae* brief be granted.

Dated: New York, New York
February 28, 1994

Respectfully submitted,

By: _____
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BRIEF OF *AMICUS CURIAE* THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

QUESTION PRESENTED

The question addressed by the *Amicus Curiae* is as follows:

> Whether the Supreme Court should adopt the interpretation of Sections 547 and 550 of Title 11, United States Code (the "Bankruptcy Code") supported by the Court below, as articulated in *Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186 (7th Cir. 1989) (hereinafter referred to as the "*Deprizio* Doctrine").

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BRIEF OF THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF THE PETITIONER

STATEMENT OF INTEREST

The American Council of Life Insurance (the "Council") is a nonprofit voluntary trade association, the membership of which totals 634 legal reserve life insurance companies doing business throughout the United States. The member companies of the Council account for 89.9 percent of the legal reserve life insurance in force in this country and afford protection to approximately 140 million insureds.

Life insurance companies are among the nation's largest lenders. At the end of 1992, life insurance companies held $881 billion of debt from corporations, partnerships and other business entities.[1] Where loans are nonrecourse, which is often the case in connection with real estate mortgage loans, or where the borrower's credit rating is less than what would be required to protect the insurer's policyholders, the loan can be closed only with additional financial security such as a guarantee of the indebtedness. Often such guarantees are available only from insiders of the borrower.

Accordingly, the focal issue of this case – whether the preference provisions of the Bankruptcy Code subject payments to a lender to the insider preference reachback of one year where the loan is guaranteed by an insider – is of grave concern to the Council and its members. Due to the long involvement of the Council and its members

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[1] American Council of Life Insurance, 1993 Life Insurance Fact Book Update p. 48 (ACLI, Washington D.C. 1993).

with loans guaranteed by insiders, and in the legislative process leading to the drafting of the Bankruptcy Code and the amendments thereto, the Council is uniquely qualified to comment on the language of the Bankruptcy Code governing preferential transfers and the effect of the *Deprizio* Doctrine on the legitimate expectations of lenders.

The Council offers this *amicus curiae* brief to support the Petitioner and to explain the serious impact that the holding below, if not reversed, could have on lenders and their willingness to make loans where an insider guarantee would be required.

SUMMARY OF ARGUMENT[2]

The *Deprizio* Doctrine represents an incorrect interpretation of the Bankruptcy Code and should be rejected by this Court for the following reasons:

1. The words "for the benefit of" Section 547(b)(1) of the Bankruptcy Code clearly mean, and were intended to prevent evasion of the preference provisions by indirect transfers to the creditor through a third party conduit. The *Deprizio* Doctrine would include any transfer to a creditor as being "for the benefit of" any other creditor

[2] The Council supports the thorough and well reasoned analysis regarding the sharp split among the courts on the *Deprizio* Doctrine and the uncertainty created by that split contained in the Petitioner's brief and the *amicus curiae* brief of the Commercial Finance Association, Inc. However, since those points have already been brought to the Court's attention, they will not be repeated here.

whose position is incidentally improved thereby. This interpretation is not supported by the language of the Bankruptcy Code or the intent of Congress.

2. If the *Deprizio* Doctrine's interpretation of "for the benefit of" were to be accepted, it might produce absurd and unintended results. For example, insider reachback limitations might be applicable to many preferential payments by general partnerships, and might also be applicable to all payments on senior mortgages where a junior mortgage is held by an insider.

3. The *Deprizio* Doctrine would treat the word "creditor" differently in different sections of the Bankruptcy Code, thus rendering the Bankruptcy Code internally inconsistent.

4. The effect of the *Deprizio* Doctrine is inequitable and carries with it potentially adverse ramifications for the national economy.

ARGUMENT

POINT I

THE *DEPRIZIO* DOCTRINE IS NOT SUPPORTED BY THE CLEAR LANGUAGE OF THE BANKRUPTCY CODE OR CONGRESSIONAL INTENT

The *Deprizio* Doctrine requires the application of the one-year insider preference period of Section 547(b)(4)(B) of the Bankruptcy Code to a payment made to a non-insider lender when an insider of the debtor has guaranteed the loan. The rationale underlying the *Deprizio* Doctrine is that the payment, while not made to the insider,

was "for the benefit of" the insider because it relieved the insider of its contingent obligations under the guarantee to the extent of the payment. Under the *Deprizio* Doctrine, the insider is a "creditor" of the payor/debtor because of the insider's contingent subrogation or indemnification rights against the payor/debtor.

This application of the one-year insider reachback period to transfers to non-insiders depends wholly on a distorted interpretation of the words "to or for the benefit of a creditor" in Section 547(b)(1). These words plainly mean that a transfer can constitute a preference if it is made to a transferee creditor directly or indirectly through a third party conduit. *See, e.g., In re Fabric Buys of Jericho, Inc.*, 33 B.R. 334 (Bankr. S.D.N.Y. 1983) (transfer to law firm could be a preference where law firm acted as a conduit when it received sums in escrow for the benefit of its client, who was a creditor of debtor). Indeed, Congress intended that this phrase would provide an effective means to recover preferential payments in situations where, rather than make a direct payment to a creditor (which payment would certainly be avoided as a preference), a transfer is made to a third party to whom a debt is presently owed by the creditor, in order to evade a bankruptcy court's ability to avoid such a payment.

The Bankruptcy Act of 1898, prior to its amendment by the Chandler Act of 1938 (the "Chandler Act"), did not specifically cover indirect transfers. Nevertheless, as explained by *Collier*, "courts of bankruptcy from the beginning placed emphasis upon the purpose and effect of a given transaction irrespective of the devious manner in which it was accomplished" since "[f]rom time immemorial courts of law have refused to sanction acts done

by indirection which, if performed directly, would be barred by the law." 3 *Collier on Bankruptcy*, ¶ 60.08 (14th ed. 1977).

The Chandler Act inserted the words "for the benefit of" to the preference provisions to codify the judicially created proscription of efforts to make transfers to creditors in devious evasion of the preference provisions. This change is described by Charles Elihu Nadler in "The Law of Bankruptcy" (1948) at Section 636 as follows:

> It is axiomatic that the courts will not permit by indirection what is prohibited directly. Here, too, it is the effect and not the mere form that is decisive. Where, therefore, the bankrupt attempts to evade a voidable preference by transferring the property in question to some third person, it will nevertheless constitute a voidable preference if the creditor gets the benefit thereof and all the other essential elements of a voidable preference are present.

The *Deprizio* Doctrine goes beyond this purpose and concludes that *any* transfer to a creditor automatically becomes a transfer for the benefit of any other creditor whose position is indirectly improved by the transfer.

While the inclusion of the words "for the benefit of" were obviously intended to deal with a transfer to a non-creditor for the benefit of a creditor, this brief does not contend that a transfer to a creditor can never be intended as a transfer to another creditor. However, where two such creditors are involved, there must be strong evidence that the transfer *which is in actual payment of the outside creditor's claim*, was really intended for the benefit of the inside creditor. No such evidence is needed

under the *Deprizio* Doctrine. Rather than analyze whether an indirect payment has been made purposely to evade a preference attack, the *Deprizio* Doctrine blindly and automatically stretches the language contained in the Bankruptcy Code to any creditor whose position is incidentally improved by the transfer, in order to obtain more funds for the estate at the expense of legitimate creditors.[3]

POINT II

THIS COURT SHOULD DECLINE TO FOLLOW THE *DEPRIZIO* DOCTRINE'S INTERPRETATION OF THE WORDS "FOR THE BENEFIT OF" AS IT WILL PRODUCE ABSURD RESULTS CLEARLY UNINTENDED BY THE DRAFTERS

The mechanistic application of the phrase "to or for the benefit of a creditor" supported by the *Deprizio* Doctrine leads to unintended and absurd results that would have a serious and adverse effect on the fair administration of the bankruptcy laws of this country, as the following illustrates.

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[3] Indeed the automatic nature of the *Deprizio* Doctrine ignores even the specific language of the Bankruptcy Code that the transfer must "benefit" the creditor. In many loans guaranteed by insiders, the guaranty is worthless in bankruptcy because the fortunes of the insider fall with the borrower. In such situations, the judgment-proof insider receives no benefit from the payment of the debt. Under the *Deprizio* Doctrine, no inquiry need be made as to whether a benefit was actually received by the insider.

A. Insider Reachback Limitations May Apply to Preferential Payments by General Partnerships on Recourse Debt Whether or Not an Insider Guaranty Is Involved

Partnerships generally have two types of debt – recourse and non-recourse.[4] Partnership law provides for joint and several liability of general partners. Unif. Partnership Act § 15. Thus, when a partnership makes a payment on an antecedent debt to a non-insider recourse creditor, it relieves all general partners of their obligation for the debt to the extent of the payment. Since the general partners are (a) "insiders" of the partnership under Section 101(31) of the Bankruptcy Code; and (b) "creditors" within the meaning of the definition of "creditor" in Section 101(10) of the Bankruptcy Code because of the partners' contingent rights under Section 18 of the Uniform Partnership Act to indemnification from the partnership, the insider preference reachback period will be applicable to any such payments.

Certainly, Congress never intended to make many such transfers by a partnership to non-insider creditors "insider transfers" for preference purposes. Yet, such a bizarre result, generating inconsistent preference treatment between transfers made by partnerships and transfers made by other business organizations such as corporations, would be the natural consequence of the acceptance of the *Deprizio* Doctrine. Accordingly, if the *Deprizio* Doctrine is widely accepted, it will result in

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[4] Long term real property mortgage debt held by a partnership is traditionally non-recourse to the partnership.

discouraging lenders from extending financing to partnerships, through which much of the legal, accounting, real estate and small commercial business in this country is conducted.

B. Preferential Payments to Senior Mortgagees Who Are Not Insiders Might Be Subject to the Insider Reachback Limitations Where a Junior Mortgage Is Held by an Insider

Businesses in need of additional funding often obtain such funds through loans from insiders secured by liens junior to existing mortgages. A payment to the senior mortgagee who is not an insider will benefit the junior insider mortgagee since it will increase the priority of the insider's lien to the extent of the payment. Under the *Deprizio* Doctrine, the payment would then be "for the benefit of" the insider. The junior insider mortgagee is clearly a creditor and if the other elements of a voidable preference are present, the one-year insider reachback provision will apply to the payments to the non-insider senior mortgagee pursuant to the *Deprizio* Doctrine.

Congress could not have intended that an outside mortgagee could become subject to the one-year preference reachback period by virtue of the borrower's act subsequent to the perfection of the mortgage over which the mortgagee has no control. The result of acceptance of the *Deprizio* Doctrine can only be to encourage the insertion of "due on encumbrance" provisions in mortgages, precluding businesses from obtaining junior financing from insiders, which may be the only method of keeping the business afloat at a time of national economic distress.

* * *

Due to the absurd consequences of adherence to the *Deprizio* Doctrine, this Court should decline to follow it. Indeed, numerous courts have declined to follow the *Deprizio* Doctrine based solely on the *inequities* inherent in it. *See, e.g., In re Aerco Metals, Inc.*, 60 B.R. 77 (Bankr. N.D. Tex. 1985); *In re R.A. Beck Builder, Inc.*, 34 B.R. 888, 894 (Bankr. W.D. Pa. 1983) ("Bank should not be penalized for its prudence in seeking a guarantor of the debt here in question"). Moreover, numerous commentators agree that the inequities posed by the *Deprizio* Doctrine require its rejection based on equitable principles. *Collier on Bankruptcy* provides a summary of this view:

> In some circumstances, a literal application of [the preference rules] would permit the trustee to recover from a party who is innocent of wrongdoing and deserves protection. In such circumstances the Bankruptcy Court should use its equitable powers to prevent an inequitable result. . . . *Otherwise, a creditor who does not demand a guaranty can be better off than one who does.*

4 *Collier on Bankruptcy* ¶ 550.02 (15th ed. 1991) (emphasis added); *see also* Robert F. Higgins & David E. Peterson, *Is There a One-Year Preference Period for Non-Insiders?*, 64 Am. Bankr. L.J. 383 (1990); David I. Katzen, *Deprizio and Bankruptcy Code Section 550: Extended Preference Exposure Via Insider Guarantees, and Other Perils of Initial Transferee Liability*, 45 Bus. Law. 511 (1990).

Given the vast inequities inherent in the *Deprizio* Doctrine, as well as the legal precedent which declines to follow it on equitable grounds, this Court should not

allow the *Deprizio* Doctrine to become the law of the United States.

POINT III

THE *DEPRIZIO* DOCTRINE'S INTERPRETATION OF THE PREFERENCE STATUTES RENDERS THOSE STATUTES INTERNALLY INCONSISTENT

The *Deprizio* Doctrine claims to be interpreting the preference provisions of the Bankruptcy Code in accordance with their "plain meaning." *See generally Deprizio, supra.* This theory of construction is sound. *Union Bank v. Wolas,* ___ U.S. ___, 112 S. Ct. 527, 116 L. Ed. 2d 514 (1991); *Toibb v. Radloff,* 501 U.S. 157, 111 S. Ct. 2197, 115 L. Ed. 2d 145 (1991). While the Deprizio court paid lip service to that principle, it failed to follow it and resorted to manipulating and finessing the plain language contained in the relevant Bankruptcy Code preference provisions in reaching its desired goal – to hold lenders liable for alleged preference payments made in the full year prior to a bankruptcy filing. Indeed, the decision undermines the legal tenet that statutes must always be interpreted with a view toward avoiding and resolving internal inconsistencies. *United States v. Turkette,* 452 U.S. 576, 580 (1981); *United States v. Ferryman,* 897 F.2d 584, 589 (1st Cir. 1990); *In re Rau,* 113 B.R. 619, 622 (Bankr. 9th Cir. 1990). The following exemplifies how the *Deprizio* Doctrine promotes internal inconsistencies within the text of the Bankruptcy Code and evades the plain meaning of the preference statutes.

Once a preference is established under Section 547 of the Bankruptcy Code, the *Deprizio* Doctrine mandates that Section 550 controls the determination of who may

be liable for repayment of the preferential transfer. That section of the Bankruptcy Code states in pertinent part:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from –
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made. . . .

Under a *Deprizio* analysis, either the lender who received the payment or the inside guarantor may be held liable for such repayment. Section 547(b)(1) of the Bankruptcy Code, however, creates a clear distinction between the time frame applicable to a preference analysis for insiders – one year – as opposed to outside lenders – ninety days. Without deference to these specific statutory delineations, the *Deprizio* court determined that outside lenders would be held liable for repayment of any preferential amounts received during the full year prior to bankruptcy. Thus, the *Deprizio* decision single-handedly quadrupled the trustee's recovery rights against an outside lender in direct contradiction to the dictates of Section 547.

In *In re Midwestern Cos.*, 102 B.R. 169 (Bankr. W.D. Mo. 1989), the court addressed the inconsistencies articulated and supported by the *Deprizio* Doctrine:

> Basic statutory construction requires that statutes be construed in harmony with one another, favoring no one statute over another, except that

> specific statutes limit the scope of general statutes. . . . Section 547 is no less significant than Section 550, so the distinction drawn in the more specific Section 547 should be permitted to survive the application of Section 550.

Id. at 173; *see also In re Cove Patio Corp.*, 19 B.R. 843, 844 (Bankr. S.D. Fla. 1982) (Section 550(a)(1) was not intended to expand the trustee's right to recover preferences as provided in Section 547).

In the present case, as in *Midwestern* and *Cove Patio*, the statutory inconsistencies supported by the *Deprizio* Doctrine should not be advanced by this Court. Rather, to preserve consistency and the plain meaning of the relevant statutes, the time frames established in Section 547 should be applied to Section 550. Thus, even if this Court should accept the *Deprizio* interpretation of "to or for the benefit of a creditor" as applicable to any other creditor benefitted by a transfer, the ninety-day period should remain applicable to a preference to the transferee creditor while the one-year period should apply to the incidental beneficiary. To do otherwise would render a nullity the congressionally mandated distinctions between the treatment of insiders and non-insiders under Section 547 of the Bankruptcy Code. The law can easily distinguish between an outside lender and an inside guarantor in assessing preference liability without instinctively allowing claims against "deep pockets."

POINT IV

THIS COURT SHOULD DECLINE TO FOLLOW THE *DEPRIZIO* DOCTRINE BECAUSE OF ITS ADVERSE IMPACT ON THE ECONOMY AS A WHOLE

Traditionally, when faced with a loan application from any business without a high credit rating, such as a "mom and pop" shop, start-up company, ailing business or professional partnership, the lender (having no other source of collateral) requests a guarantee. Given the precarious financial condition of the borrower, often the lender can only obtain an inside guarantee. In light of the *Deprizio* Doctrine, lenders fearing preference attacks on payments made to them within a year of a bankruptcy filing have two choices: (1) to make a virtually unsecured loan and forego guarantees; or (2) to decline lending to entities or individuals with less than excellent credit histories. Obviously, the wiser and safer course for the lender is to choose the latter choice. Thus, the *Deprizio* Doctrine impedes the ability of the small, start-up or faltering business to obtain desperately needed credit or cash influxes, while larger "Fortune 500" businesses or individuals with substantial net worths remain largely unaffected. *See In re Rubin Bros. Footwear, Inc.*, 119 B.R. 416, 425 (Bankr. S.D.N.Y. 1990) ("[A]s a policy matter, the Court believes that the *Levit* rule would likely impede the availability of credit to ailing businesses. Because of its potential policy implications, and because the Second Circuit has not adopted it, the Court declines to apply the *Levit* rule to the instant case"). Moreover, the *Deprizio*

Doctrine, if widely accepted, would heighten to an extreme the amount of risk-taking by lenders.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari to the Tenth Circuit should be granted.

Dated: New York, New York
February 28, 1994

Respectfully submitted,

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